

DIRECT TESTIMONY

OF

ERIC LOUNSBERRY

Energy Engineering Program

Safety and Reliability Division

Illinois Commerce Commission

Application pursuant to Section 7-204 of the Public Utilities Act for authority to engage in a Reorganization, to enter into an agreement with affiliated interests pursuant to Section 7-101, and for such other approvals as may be required under the Public Utilities Act to effectuate the Reorganization

Wisconsin Energy Corporation, Integrys Energy Group, Inc., Peoples Energy, LLC,
ATC Management Inc., American Transmission Company LLC,
The Peoples Gas Light and Coke Company, and North Shore Gas Company

Docket No. 14-0496

November 20, 2014

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1 **Q. Please state your name and business address.**

2 A. My name is Eric Lounsberry and my business address is: Illinois Commerce
3 Commission ("Commission"), 527 East Capitol Avenue, Springfield, Illinois
4 62701.

5 **Q. By whom are you employed and in what capacity?**

6 A. I am employed by the Commission as the Supervisor of the Gas Section of the
7 Energy Engineering Department of the Safety and Reliability Division. I have
8 worked for the Commission since 1989.

9 **Q. Please state your educational background.**

10 A. I received a Bachelor of Science degree in Civil Engineering from the University
11 of Illinois and a Master of Business Administration degree from Sangamon State
12 University (now known as University of Illinois at Springfield).

13 **Q. What are your primary responsibilities and duties as the Gas Section**
14 **Supervisor of the Safety and Reliability Division's Energy Engineering**
15 **Program?**

16 A. I assign other Gas Section employees or myself to cases, provide training, and
17 review work products over the various areas of responsibility covered by the Gas
18 Section. In particular, the responsibilities and duties of Gas Section employees
19 include performing studies and analyses dealing with day-to-day, and long term,
20 operations and planning for the gas utilities serving Illinois. For example, Gas

Section employees review purchased gas adjustment clause reconciliations, rate base additions, levels of natural gas used for working capital, and utility applications for Certificates of Public Convenience and Necessity. They also perform audits of utility gas meter shops and on occasion review common carrier pipeline applications.

Q. What is the purpose of this proceeding?

A. On August 6, 2014, Wisconsin Energy Corporation (“WE”) and Integrys Energy Group Inc. (“Integrys”), which includes Peoples Gas Light and Coke Company (“Peoples Gas”) and North Shore Gas Company (“North Shore”)¹, (collectively “Joint Applicants”) filed a petition requesting Commission approval to engage in a reorganization. This reorganization would allow WE to acquire 100% of the outstanding common stock of Integrys to create a new holding company – WEC Energy Group, Inc. – that will wholly own, among other companies, both Gas Companies.

Q. What are your duties and responsibilities associated with this docket?

A. I will offer an opinion regarding whether the proposed reorganization meets the requirements of Section 7-204(b)(1) of the Public Utilities Act (“Act”). 220 ILCS 5/7-204(b)(1).

Q. What are the requirements of Section 7-204(b)(1) of the Act?

¹ North Shore and Peoples Gas will be referred to collectively as the “Gas Companies”.

A. Section 7-204 of the Act requires Commission approval prior to any proposed reorganization of a utility and requires the Commission to make a number of findings, including the finding contained in Section 7-204(b)(1) of the Act. Specifically Section 7-204(b)(1) states:

the proposed reorganization will not diminish the utility's ability to provide adequate, reliable, efficient, safe and least-cost public utility service.

Q. What overall recommendation are you making in this proceeding?

A. I recommend that the Commission find that the Joint Applicants, based upon the showing made in their Direct Testimony, and upon information provided to date in discovery at this time, do not meet the requirement of Section 7-204(b)(1) of the Act.

Q. What evidence must the Applicants provide or address to ensure “the proposed reorganization will not diminish the utility’s ability to provide adequate, reliable, efficient, safe and least-cost public utility service”?

A. Based on my review of the filing, I conclude the Joint Applicants must provide or address the below topics to demonstrate “the proposed reorganization will not diminish the utility’s ability to provide adequate, reliable, efficient, safe and least-cost public utility service”. These topics include four proposed commitments and four recommendations for the Joint Applicants.

- Joint Applicants will reaffirm Peoples Gas’ commitment to the Commission in Docket Nos. 09-0166/09-0167 (Consol.) to complete the Accelerated Main Replacement Program (“AMRP”) by the end of 2030.

- 63 • Peoples Gas will implement fully all recommendations in the final report of
64 the investigation of Peoples Gas' AMRP completed at the direction of the
65 Commission in its June 18, 2013 Order in Docket No. 12-0512 under the
66 authority granted in Section 8-102 of the Act (220 ILCS 5/8-102).
67 Implementing a recommendation means taking action per a
68 recommendation or providing an explanation with all necessary
69 documentation and studies to demonstrate to the satisfaction of the
70 Commission Staff that strict implementation of the recommendation is not
71 possible, practical, or reasonable, along with an alternative plan to
72 accomplish the goals of the recommendation as fully as is possible,
73 practical, and reasonable.
- 74 • Peoples Gas will cooperate fully with the Commission's Staff and
75 consultants as they work to verify that Peoples Gas has implemented all
76 the recommendations in the final report on the Peoples Gas' AMRP
77 investigation. Cooperation means to provide requested personnel for
78 interviews in a timely manner and without restrictions, to answer written
79 questions in a reasonable time with accurate and complete information,
80 and to make all information, equipment, work sites, work forces and
81 facilities available for inspection when requested.
- 82 • Peoples Gas will provide written reports to the Commission Staff on or
83 before January 1 and July 1 of each year, beginning in the year 2018 and
84 ending only after the completion of the AMRP or any successor program
85 that replaces the AMRP, about any change in implementation of
86 recommendations in the final report of the investigation of Peoples Gas'
87 AMRP. An officer of Peoples Gas shall provide written verification of the
88 accuracy and completeness of each report.

89 First, I recommend that the Joint Applicants provide additional information about
90 the PricewaterhouseCoopers ("PwC") audit of the AMRP and address any PwC
91 recommendations. Specifically, the Joint Applicants should provide:

- 92 • A summary of each recommendation made by PwC;
- 93 • A description of all action taken as a result of each recommendation;
- 94 • The start date of implementation of each recommendation;
- 95 • The ending date, if implementation of the recommendation is complete;
- 96 • The current status of implementing each recommendation; and
- 97 • If implementation of a recommendation is not complete, the Joint
98 Applicants should provide a commitment to complete the implementation
99 of the recommendation by a certain date.

Second, I recommend that the Joint Applicants address and update the appropriate Full Time Equivalent (“FTE”) employee levels for its Gas Utilities and Integrys Business Support Group. In particular, I request that the Joint Applicants update their proposed FTE levels to the amounts discussed in the Joint Applicants’ response to Staff Data Request (“DR”) ENG 3.04. As part of this second recommendation, the Joint Applicants should separate their FTE commitments into their individual companies, instead of presenting them as an aggregate value and the Joint Applicants should include the statement: “Peoples Gas agrees and commits that it shall implement any increased staffing levels recommended by the Liberty audit recommendations as an overall increase in the agreed upon FTE levels for Peoples Gas” in its FTE commitment language.

Third, I recommend that Joint Applicants provide a commitment regarding capital addition investment levels, separated into specific amounts for North Shore and Peoples Gas (AMRP and non-AMRP levels) for the years 2015 through 2017. Since the amounts shown in JA Exhibit 4.1 are confidential, I also recommend the Joint Applicants provide the commitment values in a non-confidential manner. Finally, the Joint Applicants should provide support for the amounts selected, including full discussion of any differences between the proposed values and the amounts shown in JA Exhibit 4.1. For example, the Joint Applicants responses to Staff DR ENG 3.01 and 3.02 discuss why certain values in JA Exhibit 4.1 are not consistent with other responses provided to Staff.

121 My fourth and final recommendation is for the Commission to direct the Gas
122 Companies to cease their reporting on Condition #24 from Docket No. 06-0540.

123 **Q. Do you have any attachments to your testimony?**

124 A. Yes. I have the follow attachments for my testimony.

125 Attachment 1 JA Response to Staff DR REV ENG 2.07 Attach 01

126 Attachment 2 JA Response to Staff DR REV ENG 2.07 Attach 02

127 **Review Associated with Section 7-204(b)(1)**

128 **Q. What information did you review to determine if the Joint Applicants met**
129 **the Section 7-204(b)(1) requirement?**

130 A. I reviewed the Joint Applicants' testimony of Allen Leverett (JA Ex. 1.0), John
131 Reed (JA Ex. 3.0), and James Schott (JA Ex. 4.0), their Application, as well as
132 their responses to Staff and Intervener data requests.

133 **Q. What considerations guided your analysis?**

134 A. My review focused on the preparations WE made prior to proposing the
135 reorganization with Integrys. I examined the information WE provided about its
136 review of Integrys' assets and operations and its attempts to familiarize itself with
137 them, in particular Peoples Gas' ongoing AMRP. To do this, I examined what
138 WE provided in response to Staff DRs asking for documentation of WE's due
139 diligence review of Integrys.

Q. Were you able to determine what effect the Joint Applicants' proposed reorganization would have on the Gas Companies' ability to provide adequate, reliable, efficient, safe and least-cost public utility service?

A. No, I was not able to do so. The Gas Companies have provided insufficient information to make that determination. Therefore, if no further information is provided in this proceeding regarding the reorganization's affect on the Gas Companies' ability to provide adequate, reliable, efficient, safe, and least-cost service, I recommend that the Commission decline to make a finding that the proposed reorganization will not diminish the Gas Companies' ability to provide such service. Because the Joint Applicants provided insufficient information to date to make that required finding, I also recommend that the Commission decline to approve this reorganization.

Joint Applicants' Filing

Q. What did the Joint Applicants indicate in their filing regarding their ability to meet the Section 7-204(b)(1) requirements?

A. The Application indicates that:

Wisconsin Energy has a strong record of maintaining the financial strength of its regulated subsidiaries and operating them reliably, efficiently, and safely. Under Wisconsin Energy's ownership, the Gas Companies will continue to provide adequate, reliable, efficient, safe, and least-cost public utility service. Wisconsin Energy will continue Integrys' existing commitment to Peoples Gas' AMRP for the accelerated improvement of its distribution system. Wisconsin Energy's commitment to industry best practices and operational excellence will help ensure that a high quality of service is provided to the Gas Companies' customers. Wisconsin Energy

has a long history of customer satisfaction with respect to service reliability and quality. Wisconsin Energy intends that the same high level of service be delivered to the Gas Companies' customers. The Gas Companies' ability to continue providing adequate, reliable, efficient, safe and least-cost service is further ensured by Wisconsin Energy's commitments to maintain a level of employment in Illinois, continue ongoing training programs, and keep the base rates to be established by the Commission in the Gas Companies' pending rate cases unchanged for a period of more than two years. (Application, 17)

The Joint Applicants also provided various assurances or commitments in their testimony. In particular, Mr. Leverett's direct testimony indicated that, from a customer perspective, the reorganization between WE and Integrys would be seamless and that the reorganization would have no adverse impact on Gas Companies' customers. (JA Ex. 1.0, 16) He also indicated WE would honor existing union agreements and noted the reorganization would not result in large-scale layoffs and that the vast majority of any employee headcount reduction would occur through attrition. (*Id.*, 17) Next, he indicated WE would commit, for two years after the closing of the reorganization, to maintain at least 1,953 full time equivalent ("FTE") positions in Illinois and to maintain all existing training programs. (*Id.*, 18) Further, Mr. Leverett indicated WE would continue the AMRP, assuming the Rider QIP remained in effect and that WEC Energy Group and Peoples Gas remained financially capable of doing so. (*Id.*, 19) Finally, Mr. Leverett indicated that when the results of the Commission's audit of Peoples Gas' AMRP were made available, WEC Energy Group would carefully review the results and, after closing and ensure that Peoples Gas would work to coordinate with the City of Chicago in the execution of the AMRP. (*Id.*, 20)

Mr. Reed's direct testimony repeated many of the topics discussed above by Mr. Leverett (JA Ex. 3.0, 8); however, Mr. Reed indicated that the reorganization will create certain operational benefits. Specifically, Mr. Reed noted that the reorganization will create a combined company with the operational expertise, scale and resources to ensure that Illinois customers continue to enjoy adequate, reliable, efficient, safe and affordable service. (*Id.*, 31) Mr. Reed then indicated that Integrys has been a leader in developing and implementing gas infrastructure modernization projects in an urban environment. *Id.* Finally, Mr. Reed indicates, in response to a question about 7-204(b)(1) requirements, that the reorganization will provide the Gas Companies with enhanced access to capital and reasonable terms to finance their capital investment requirements and that WEC Energy Group may be able to deploy its strong cash flows to help fund Peoples Gas' AMRP. (*Id.*, 41)

Mr. Schott's direct testimony indicated that the reorganization would have no impact on the day-to-day operation of the Gas Companies. (JA Ex. 4.0, 6) He indicated that the Gas Companies' customers would experience no reduction in service quality in terms of service continuity, call center availability, emergency responses, and related utility services. (*Id.*, 7)

Q. What does the information that the Joint Applicants provided in their testimony and Application indicate to you?

A. Based solely on the testimony and Application, the Joint Applicants intend that the proposed reorganization will have no *initial* effect on the Gas Companies'

215 customers. However, there is insufficient information for me to form a conclusion
216 regarding any longer-term effect of the proposed reorganization.

217 **Q. Do you consider any of the information discussed above as lacking or**
218 **failing to address the requirements of 7-204(b)(1)?**

219 A. Yes. There are four comments in the above testimony that indicate the
220 Applicants' response to Section 7-204(b)(1) is deficient.. First, Mr. Reed
221 indicated that the reorganization will provide the Gas Companies with enhanced
222 access to capital and reasonable terms to finance their capital investment
223 requirements and that WEC Energy Group may be able to deploy its strong cash
224 flows to help fund Peoples Gas' AMRP. (JA Ex. 3.0, 41)

225 Second, Mr. Leverett noted that once the Commission's audit of Peoples Gas'
226 AMRP is available, WEC Energy Group would carefully review the results and,
227 after closing, ensure that Peoples Gas would work to coordinate with the City of
228 Chicago in the execution of the AMRP. (JA Ex. 1.0, 20)

229 Third, Mr. Leverett indicated WE would continue the AMRP assuming the Rider
230 QIP remained in effect and that WEC Energy Group and Peoples Gas remained
231 financially capable of doing so. (*Id.*, 19)

232 Fourth, Mr. Reed indicated that Integrys has been a leader in developing and
233 implementing gas infrastructure modernization project in an urban environment.
234 (JA Ex. 3.0, 31)

235 Enhanced Access to Capital and Funding

236 **Q. Why is Mr. Reed's comment regarding enhanced access to capital and**
237 **funding of the AMRP an inadequate response to the requirement in Section**
238 **7-204(b)(1)?**

239 A. The Joint Applicants' position is inadequate for two reasons. First I am aware of
240 the PUA requirement in 7-204(b)(4) that deals directly with the utility ability to
241 raise capital and maintain its capital structure. Therefore, in my view, Mr. Reed's
242 comment should apply to finding 4, not finding 1, of 7-204(b).

243 Also, Mr. Reed's comment suggests that Integrys is not currently or is not
244 capable in the near future of financing its capital investment requirements
245 including Peoples Gas' AMRP. I do not testify to capital or capital structure
246 topics, but I am aware that the Gas Companies are currently before the
247 Commission seeking an increase in their base rates in Docket Nos. 14-0224/14-
248 0225 (Cons.) and the Commission authorized Peoples Gas in Docket No. 13-
249 0534 pursuant to Section 9-220.3 of the Act to operate a QIP Rider. My
250 expectation is that the combination, the base rate increase and the revenue from
251 the QIP Rider, provides the Gas Companies with sufficient funds to operate.
252 Therefore, I am not sure of the basis for or the point of Mr. Reed's comment as it
253 applies to the Section 7-204(b)(1) finding. The Commission's consideration of
254 the merger would benefit from an explanation in Mr. Reed's rebuttal testimony.

255 Commission's Audit of AMRP

256 **Q. Why does Mr. Leverett's comment that once the Commission's audit of**
257 **Peoples Gas' AMRP were made available, WEC Energy Group would**
258 **carefully review the results and, after closing, ensure that Peoples Gas**
259 **would work to coordinate with the City of Chicago in the execution of the**
260 **AMRP an inadequate response to the requirement in Section 7-204(b)(1)?**

261 A. The Joint Applicants' position is inadequate because they do not make any
262 specific commitments to implement the audit findings, aside from those findings
263 that address Peoples Gas coordination efforts with the City of Chicago. Unless
264 Mr. Leverett knows what Liberty is going to recommend, there is no good reason
265 to speculate as to what any of Liberty's recommendations will be, let alone
266 assume there is a recommendation for better coordination with the City.

267 **Q. What Commission audit is Mr. Leverett referencing?**

268 A. In Docket No. 12-0511/12-0512 (Cons.), the Commission adopted Staff's
269 recommendation to hire an engineering consulting firm to investigate Peoples
270 Gas AMRP and make recommendations about its findings. On May 14, 2014,
271 the Commission awarded Liberty Consulting Group ("Liberty") with the contract.
272 The contract includes two phases, Phase 1 (Investigation) and Phase 2
273 (Verification). Liberty must provide a final report at the end of Phase 1, which
274 ends on or before April 29, 2015. Phase 2, which begins at the end of Phase 1,
275 continues for a period of two years, and involves Liberty verifying that Peoples

276 Gas is implementing its recommendations.

277 The Liberty Audit report is likely to make recommendations much broader in
278 scope then merely Peoples Gas' coordination issues with the City of Chicago. In
279 other words, the Joint Applicants' limited commitment to coordinate with the City
280 of Chicago in executing AMRP does not commit the Joint Applicants to address
281 the potential of more diverse recommendations coming from the Liberty audit.

282 Commitment to Continue AMRP

283 **Q. Do you consider Mr. Leverett's statement that WE would continue the**
284 **AMRP assuming the Rider QIP remained in effect and that WEC Energy**
285 **Group and Peoples Gas remained financially capable of supporting the**
286 **AMRP an adequate response to the requirement in Section 7-204(b)(1)?**

287 A. No, because if the Joint Applicants decide to discontinue the AMRP, it would
288 violate a Commission Order. Specifically, the Commission indicated:

289 Due to the many benefits that the accelerated plan provides to
290 ratepayers, the Commission is of the opinion that time is of the
291 essence and hereby requires completion of the acceleration plan
292 project by 2030. Any variance from this completion date will require
293 the Company to seek the Commission's approval. (emphasis
294 added) (North Shore Gas Co. and the Peoples Gas Light and Coke
295 Company, ICC Order Docket Nos. 09-0166/09-0167 (Cons.), 196,
296 January 21, 2010)

297 **Q. What does the above Commission Order indicate to you?**

298 A. Unless the Joint Applicants successfully petition the Commission to alter their
299 current 2030 commitments to complete the AMRP, they must make all efforts to

300 complete the AMRP by 2030. Completing AMRP by 2030 is not conditional on
301 continued existence of QIP.

302 **Q. Do you have any recommendations for how the Joint Applicants can**
303 **address this deficiency?**

304 A. Yes. I recommend the Joint Applicants reaffirm their commitment to the
305 Commission to complete the AMRP by 2030 by making the following
306 commitment in their testimony:

- 307 • Joint Applicants will reaffirm Peoples Gas' commitment to the Commission
308 in Docket Nos. 09-0166/09-0167 (Consol.) to complete the Accelerated
309 Main Replacement Program ("AMRP") by the end of 2030.

310 Integrys as a Leader in Developing and Implementing AMRP

311 **Q. Is Mr. Reed's comment that Integrys has been a leader in developing and**
312 **implementing a gas infrastructure modernization project in an urban**
313 **environment sufficient to demonstrate the Joint Applicants meet the**
314 **requirement in Section 7-204(b)(1)?**

315 A. No. I am not aware of any basis for this general statement. However, I am
316 aware of at least three instances where Staff has addressed Peoples Gas'
317 AMRP, which is the only gas infrastructure modernization project in an urban
318 environment of which I am aware that Integrys is undertaking. In those
319 instances, Staff raised issues with the AMRP being behind schedule and
320 deficiencies in project management.

First, in Docket Nos. 09-0166/09-0167 (Cons.), the Commission provided the following:

Staff's recommendation for the hiring of consultants, it explains, is driven by the need for Commission oversight. Mr. Marano tells us that the Commission will be able to clearly track PGL's expenditures against a clear set of time milestones such as types and miles of pipe replaced, meters relocated, and regulator vaults replaced and/or installed. We are made to understand that PGL will provide Staff a detailed annual report that contains information on the program's progress and both planned and completed corrective actions to mitigate any program deficiencies. We disagree with Mr. Marano, that these measures will result in the Commission having all the information necessary to conduct its oversight responsibilities in ensuring that PGL spends its funds efficiently, and that it effectively meets the goals of the accelerated program.

We understand the great importance and the critical need to have a successful acceleration plan for PGL and the ratepayers. The Commission agrees with [Staff witness Harold R.] Stoller's recommendations elicited in his testimony that some Commission oversight is needed for the successful completion of the acceleration program. He maintains that the Commission cannot, —reasonably and responsibly rely on Peoples Gas to resolve the problem on its own going forward without in some way keeping a close eye on the situation.¶ Staff Exhibit 14.0 at 6. The Commission finds that the nature of the plan requires additional oversight to insure the successful completion of the plan in a prudent and reasonable manner. To accomplish this goal we conclude it reasonable and appropriate that, in addition to the Company's annual internal audit process, there shall be an independent audit of the plan every 5 years, beginning with the 5th year after the plan's inception, until the plan's completion in 2030. The audit shall be submitted to the Commission for its review.

Due to the many benefits that the accelerated plan provides to ratepayers, the Commission is of the opinion that time is of the essence and hereby requires completion of the acceleration plan project by 2030. Any variance from this completion date will require the Company to seek the Commission's approval. (emphasis added) ((North Shore Gas Co. and the Peoples Gas Light and Coke Company, ICC Order Docket Nos. 09-0166/09-0167 (Cons.), 196, January 21, 2010)

Second, I note that in Docket No. 12-0511/12-0512 (Cons.) (the Gas Companies 2012 rate cases), Staff took issue with the manner that Peoples Gas was operating its AMRP. In particular, the Commission agreed with Staff's recommendation to hire an engineering consulting firm to investigate Peoples Gas AMRP and make recommendations about its findings. In particular, the Commission noted:

Staff's position, discussed above, referenced the Peoples rate case from four years ago: "Peoples Gas' distribution system... is approaching the point that further aging and deterioration will eventually cause replacement to maintain public safety to become an emergency matter". Docket No. 09-0167, ICC Staff Ex. 14.0 at 6. Staff witness [Philliph R.] Buxton's rebuttal testimony makes clear that Staff continues to agree with that statement, as does this Commission.

Further, Mr. Buxton avers: "There is no reason for the Commission to believe that Peoples can complete its AMRP in 20 years as it convinced the Commission it should back in 2009 and no way for the Commission to know what the completed AMRP will cost... The AMRP is behind schedule and will fall further behind in 2013." Staff Ex. 20.0 at 9.

Part of the problem with the AMRP is the lack of detail. Staff examined Peoples' submissions to Staff DR ENG 2.12, which asked for a detailed explanation of its five-year plan for the AMRP, including all costs. They found: "There is no discussion of costs in the White Paper. There is no discussion of resource requirements or project management. The response to Staff DR ENG 2.12 states that the AMRP budget for 2013 is \$220.75 million, but does not explain how Peoples arrived at that number and Attachment 01, the White Paper, does not address the issue either." *Id.* At 19. Additionally, Peoples also stated that they "have not determined the funding level past the year 2013". *Id.* Attachment 20.02.

For reasons detailed in Staff witness Buxton's rebuttal testimony (Staff Ex. 20.0 at 23-24) and immediately above, this Commission adopts Staff's proposed two-phase investigation of the AMRP under Section 8-102 of the Act (220 ILCS 5/8-102) ending in a public document report. This Order directs Staff to conduct the

tasks outlined on pages 3-8 of Staff Ex. 20.0 and directs Peoples to comply with the same. (emphasis added) ((North Shore Gas Co. and the Peoples Gas Light and Coke Company, ICC Order, Docket Nos. 12-0511/12-0512 Consol., 61, June 18, 2013)

Finally, I note in the most recent rate case pending involving the Gas Companies, Peoples Gas initially requested \$238.7 million in 2014 Rider QIP Additions, with the majority of the requested cost associated with the AMRP. (North Shore Gas Co. and the Peoples Gas Light and Coke Company, ICC Docket Nos. 14-0224/14-0225 (Cons.), NS-PGL Ex. 22.14P, p. 1, line 1, column D) Staff agreed with the Attorney General's witness that this amount was too high and ultimately recommended \$116.0 million instead. (*Id.*, NS-PGL Ex. 37.5 P, line 1) Peoples Gas also reduced its requested amount to \$173.2 million, which is a reduction of \$65.5 from its original request (238.7 – 173.2). (*Id.*, NS-PGL Ex. 22.14 P, p. 1, line 1, column E) In other words, Peoples Gas reduced its expected 2014 Rider QIP outlay in 2014 by 27.4% ($65.5/238.7 * 100$), which is yet another example of Peoples Gas not being able to maintain its estimated construction schedule for its AMRP.

Q. Given the inadequate commitment the Joint Applicants provide for the AMRP and Staff's past issues with Peoples Gas' activities with the AMRP, do you have any recommendations for the Joint Applicants?

A. Yes. I recommend that the Commission order the Joint Applicants to agree to the following commitments regarding the Liberty audit of Peoples Gas' AMRP:

- Peoples Gas will implement fully all recommendations in the final report of the investigation of Peoples Gas' AMRP completed at the direction of the

Commission in its June 18, 2013 Order in Docket No. 12-0512 under the authority granted in Section 8-102 of the Act (220 ILCS 5/8-102). Implementing a recommendation means taking action per a recommendation or providing an explanation with all necessary documentation and studies to demonstrate to the satisfaction of the Commission Staff that strict implementation of the recommendation is not possible, practical, or reasonable, along with an alternative plan to accomplish the goals of the recommendation as fully as is possible, practical, and reasonable.

- Peoples Gas will cooperate fully with the Commission's Staff and consultants as they work to verify that Peoples Gas has implemented all the recommendations in the final report on the Peoples Gas' AMRP investigation. Cooperation means to provide requested personnel for interviews in a timely manner and without restrictions, to answer written questions in a reasonable time with accurate and complete information, and to make all information, equipment, work sites, work forces and facilities available for inspection when requested.
- Peoples Gas will provide written reports to the Commission Staff on or before January 1 and July 1 of each year, beginning in the year 2018 and ending only after the completion of the AMRP or any successor program that replaces the AMRP, about any change in implementation of recommendations in the final report of the investigation of Peoples Gas' AMRP. An officer of Peoples Gas shall provide written verification of the accuracy and completeness of each report.

Due Diligence

Q. Please explain what you are referring to when you talk about due diligence or a due diligence report.

A. I am referring to the investigation that is initiated when one company is contemplating acquiring or merging with another company and the reports that are a result of that investigation. The acquiring company performs an investigation of the target company to ensure the target is healthy and worth the asking price. A thorough due diligence review would look into all aspects of a company, including financial records, personnel, legal and regulatory issues,

454 physical assets, and operational procedures and costs. It would be typical for the
455 investigators to take detailed notes and prepare due diligence reports for the
456 review of the acquiring company's officers and directors. These reports make it
457 possible for the company leaders to accurately evaluate the company they are
458 about to acquire.

459 **Q. Based on your review, did the Joint Applicants conduct a thorough due**
460 **diligence review?**

461 A. No. My understanding is that the Joint Applicants only conducted a high level
462 review of Integrys without any detailed review of operating practices of the Gas
463 Companies or of AMRP.

464 **Q. Do you consider the lack of a thorough due diligence review as a**
465 **deficiency?**

466 A. Yes. The Joint Applicants claim the proposed reorganization will strengthen the
467 WEC Energy Group's operating companies, including the Gas Companies, by
468 integrating best practices in distribution operations, larger capital project
469 management, gas supply, system reliability, and customer service. However, the
470 Joint Applicants conducted no review to determine the level of effort and
471 expenditure it would take on their part to make any of this happen, assuming they
472 can make any of these changes happen at all. This is especially true of larger
473 capital project management, which is what AMRP clearly requires. Therefore, I

474 conclude that Joint Applicants' claims are broad, unsubstantiated
475 generalizations.

476 **Q. Why would a due diligence review be important to WE?**

477 A. WE is assuming financial, regulatory, and legal obligations by reorganizing with
478 Integrys. The purpose of the due diligence review is to assess the risk
479 associated with those obligations. The pertinent information from the due
480 diligence review must be conveyed to WE's officers and board of directors,
481 because the people making the corporate decisions must have access to all of
482 the relevant information. Without a thorough due diligence review and report,
483 WE's decision makers could not know the risk that WE is assuming, how much
484 Integrys is worth, or whether the two companies are a good fit for each other
485 operationally.

486 **Q. Why did you examine the due diligence reviews?**

487 A. I examined the due diligence reviews to determine the level of familiarity WE has
488 with how Integrys operates and the risk WE is assuming when it becomes
489 responsible for the Peoples Gas aging gas distribution infrastructure and the
490 AMRP program. WE would need to be familiar with Integrys' practices in order to
491 determine whether Integrys' practices are consistent with WE's current
492 operations, and/or how to integrate the two companies' practices. Inconsistent
493 practices might lead to the conclusion that the reorganization is not a good fit or
494 that one or both parties must make significant changes to their practices in order

to integrate them. If WE does not properly understand the business or have the expertise to operate it, then WE's statements that:

The Transaction is in the best interests of utility customers, investors, and the public because it will:

strengthen the WEC Energy Group's operating companies, including the Gas Companies, by integrating best practices in distribution operations, larger capital project management, gas supply, system reliability, and customer service. (Application, 1-2)

cannot be relied up to ensure that WE will be able to strengthen the WEC Energy Group's operating companies, including the Gas Companies, by integrating best practices in distribution operations, larger capital project management, gas supply, system reliability, and customer service.

The Commission has made it clear in the past that it has concerns about Peoples Gas' aging cast iron and ductile iron gas mains and Peoples Gas' willingness and ability to successfully complete the AMRP. It seems reasonable that WE would make itself familiar with Peoples Gas' aging infrastructure. Such a review would have looked at the issues created by the large amount of cast iron and ductile iron gas mains remaining in service, the AMRP program with its scheduling and budgeting problems. WE should have also looked at how the infrastructure needs could pose risks to investors, for example, the magnitude of the rate base investment AMRP will constitute for Peoples Gas compared to the remainder of its rate base.

518 A due diligence audit provides a rare opportunity for the Commission to review
519 an outside party's assessment of a utility's system. The absence of a detailed
520 due diligence report on the Gas Companies infrastructure, especially AMRP,
521 reflects a failure by WE to conduct a complete analysis of Integrys. It also limits
522 Staff's analysis and the information that the Commission has when evaluating the
523 benefits of the merger.

524 **Q. What due diligence review did the Joint Applicants conduct on Peoples**
525 **Gas AMRP?**

526 A. According to the Joint Applicants' response to Staff DR ENG 2.10 WEC reviewed
527 Public Integrys investor deck information, the QIP tariff, Peoples Gas's 2/19/14
528 Rider QIP filing with the ICC, and Public Act 098-0057 (provides statutory
529 authority for QIP Riders).

530 **Q. Did any of the Joint Applicants' responses to the above referenced data**
531 **request indicate that WE had conducted a thorough due diligence review**
532 **of the Gas Companies' operating practices or any specific review of**
533 **Peoples Gas' AMRP?**

534 A. No. The Joint Applicants' responses indicated that only a high level review of
535 Integrys took place without any detailed review of operating practices of the Gas
536 Companies or of AMRP. In my view, the primary focus of WE's review of AMRP
537 was whether Peoples Gas is allowed to recover AMRP costs through its QIP
538 Rider without the need to file for a rate increase under Section 9-201.

539 **Q. Did the Joint Applicants' response to any other data request confirm your**
540 **conclusion that WE did not conduct any detailed review of the operating**
541 **practices of the Gas Companies?**

542 A. Yes. The Joint Applicants' response to AG 4.01, which asked, in part, if WE had
543 requested and reviewed a detailed work plan of the AMRP. The Joint Applicants'
544 responses indicated:

545 Neither WEC nor any other Joint Applicant requested PGL to
546 provide a detailed work plan of the AMRP as part of its due
547 diligence review. It is not standard practice when performing due
548 diligence for the acquisition by one utility holding company of
549 another utility holding company to examine and/or analyze the day-
550 to-day operational details of each individual utility where, as with
551 the Reorganization here, the intention is for the acquired utilities to
552 remain in their current forms, without any large reductions in force,
553 and, immediately after the close of the Reorganization, to continue
554 operating as they did prior to the Reorganization. Further
555 responding, the Joint Applicants state that the review and analysis
556 of the type of detailed work plan referred to in this data request
557 typically would not occur until such time as the companies that are
558 part of the Reorganization begin integration activities, not when
559 conducting pre-transaction due diligence. (JA Response to AG
560 4.01)

561 **Q. Does the lack of a thorough due diligence review demonstrate that the**
562 **Joint Applicants have not met the requirement of 7-204(b)(1)?**

563 A. Yes. The Joint Applicants claim the proposed reorganization will strengthen the
564 WEC Energy Group's operating companies, including the Gas Companies, by
565 integrating best practices in distribution operations, larger capital project
566 management, gas supply, system reliability, and customer service. However, the
567 Joint Applicants conducted no review to determine the level of effort and

expenditure it would take on their part to make any of this happen, assuming they can make any of these changes happen at all. This is especially true of larger capital project management, which is what AMRP clearly requires. Therefore, I conclude that Joint Applicants' claims are broad, unsubstantiated generalizations.

In my opinion, the AMRP is the most risky capital project undertaken by a utility in Illinois since Commonwealth Edison Company and Illinois Power Company began constructing their nuclear powered generation plants, each of which ultimately cost billions of dollars each to complete. It is very clearly not, as WE has described it above, part of Peoples' Gas "day-to-day" operations. By the time the AMRP is complete, I conservatively estimate it will have multiplied Peoples Gas' rate base by a factor of 2.25 (projected 2015 rate base is about \$1.67 billion (Docket No. 14-0224/14-0225 (Cons.), Staff Initial Brief, Appendix B, p. 4) with 15 remaining years of AMRP remaining at an assumed cost of \$.25 billion per year * 15 years = \$3.75 billion, $3.75/1.67 = 2.25$).

PricewaterhouseCoopers Reports

Q. Describe the PricewaterhouseCoopers ("PwC") reports.

A. The Joint Applicants' response to Staff data request ENG 2.07 provided two reports from PwC. These documents, attached to my testimony as Staff Exhibit 2.0, Attachment 1 and Attachment 2, respectively, are PwC audit reports of

Peoples Gas' AMRP. The first PwC audit report is dated April 6, 2012 ("Report 1"), the second is dated September 7, 2012 ("Report 2").

Integrus engaged PwC to perform a consultative review of the governance and controls over the start-up of the AMRP. For the first audit report, Peoples Gas requested PwC to conduct an objective assessment of the key elements of the AMRP, including its existing and planned organizational structure, policies, procedures and recommendations for strengthening the AMRP control environment based on the knowledge and expertise of leading practice for major engineering and construction programs. (Report 1, 3) In the second audit report, Peoples Gas engaged PwC to perform a follow-up review of the AMRP to assess progress on the implementation of the high risk process improvements identified in PwC's first report. (Report 2, 3)

In other words, when Peoples Gas first initiated AMRP, it engaged PwC to review its operations and to make recommendations on how to improve Peoples Gas' AMRP processes. Peoples Gas also had PwC follow-up on its initial assessment on improving Peoples Gas' AMRP processes by verifying that Peoples Gas had initiated or started to initiate the recommended changes.

Q. Do you have any recommendations about these reports?

A. Yes. I request that the Joint Applicants in their rebuttal testimony address each PwC recommendation by providing the following:

- A summary of each recommendation made by PwC;

- 609 • A description of all action taken as a result of each recommendation;
- 610 • The start date of implementation of each recommendation;
- 611 • The ending date, if implementation of the recommendation is complete;
- 612 • The current status of implementing each recommendation; and
- 613 • If implementation of a recommendation is not complete, the Joint
- 614 Applicants should provide a commitment to complete the implementation
- 615 of the recommendation by a certain date.

616 **Q. Why is the information regarding implementation important for the Joint**
617 **Applicants to demonstrate they are meeting the requirements of 7-204(b)(1)**
618 **of the Act?**

619 A. The implementation information is necessary for two reasons. First,
620 implementing the PwC recommendations demonstrates the Joint Applicants have
621 a commitment to meet the 2030 deadline for the AMRP. Conversely, the Joint
622 Applicants failure to implement the recommendations without good cause would
623 demonstrate the lack of commitment to comply with the Commission-ordered
624 2030 deadline.

625 Second, if the Joint Applicants are still in the process of implementing any of the
626 recommendations, then a commitment on the Joint Applicants' part would
627 provide support for making a recommendation that the proposed reorganization
628 will not diminish the utility's ability to provide adequate, reliable, efficient, safe
629 and least-cost public utility service.

630 **Full Time Equivalent Employees**

631 **Q. Describe the Joint Applicants commitment regarding the level of**
632 **employees for Integrys.**

633 A. Mr. Leverett indicated WE would commit for two years after closing of the
634 reorganization to maintain at least 1,953 FTE positions in Illinois and to maintain
635 all existing training programs. (JA Ex. 1.0, 18)

636 **Q. How do those FTE positions apply to Illinois?**

637 A. The Joint Applicants' response to Staff data request ENG 1.23 indicated that

638 The commitment in Mr. Leverett's testimony was to locate an
639 aggregate number of FTE positions in Illinois for two years after the
640 closing of the Transaction. That commitment was based on the
641 following headcount located in Illinois, but the commitment is in the
642 aggregate, not by company.

643	Peoples Gas	1,294 FTEs
644	North Shore	166 FTEs
645	Integrys Business Support	493 FTEs

646 **Q. How many FTEs did the Gas Companies have as of January 1, 2014?**

647 A. According to the Joint Applicants' response to Staff DRs ENG 1.13 and ENG
648 1.19, Peoples Gas reported 1,299.5 FTEs and North Shore reported 164.7 FTEs.

649 **Q. How many FTEs do the Gas Companies project to have as of January 1,**
650 **2015?**

651 A. The Joint Applicants' responses to Staff DRs ENG 1.14 and ENG 1.20 indicate
652 that the Gas Companies projected FTE for January 1, 2015 of 1,356 for Peoples
653 Gas and 177.7 for North Shore.

654 **Q. Why do the FTE values that the Joint Applicants plan to retain differ from**
655 **the values that that the Gas Companies have indicated?**

656 A. The Joint Applicants, in their response to Staff DR ENG 3.04 indicated, in part,
657 that:

658 The full-time-equivalent employee (FTE) positions commitment
659 provided in the Joint Applicants' Application and in Mr. Leverett's
660 testimony, as stated in the Joint Applicants' response to Staff data
661 request ENG 1.23, is a commitment to locate, at a minimum, an
662 aggregate number of FTE positions in Illinois for two years after the
663 closing of the Transaction. The 1,953 FTEs are a "floor-level" of
664 FTEs below which the post-merger company, WEC Energy Group,
665 will not allow its employment levels in Illinois to fall for a period of
666 two years after the closing of the Transaction. The aggregate floor-
667 level level of 1,953 FTEs to be located in Illinois, and the levels of
668 FTEs listed for Peoples Gas, North Shore, and Integrys Business
669 Support in the Joint Applicants' response to Staff data request ENG
670 1.23 from which that number was derived, are based on positions in
671 place as of December 31, 2013.

672 **Q. Did the Joint Applicants' response to Staff DR ENG 3.04 indicate anything**
673 **else?**

674 A. Yes. The Joint Applicants' response indicated, in part, that:

675 ...The 1,953 FTEs in this commitment do not represent an intended,
676 forecasted, or targeted level of post-merger FTEs for WEC Energy Group
677 in Illinois... For purposes of what levels of FTEs the Joint Applicants

678 forecast and plan for there to be in place at Peoples Gas and North Shore
679 in the years 2015 and 2016, the Joint Applicants adopt the levels of FTEs
680 forecasted by Peoples Gas and North Shore in their pending rate cases
681 (Docket Nos. 14-0224/14-0225 consol.), which are the FTE levels for
682 Peoples Gas and North Shore provided in the Joint Applicants' responses
683 to Staff data requests ENG 1.14 and ENG 1.20, respectively."

684 **Q. Are the Joint Applicants' updated FTE commitment levels for the Gas**
685 **Companies sufficient to met the requirement in Section 7-204(b)(1)?**

686 A. No. While the new proposed values are an improvement, there are other factors
687 that could affect the FTE levels of the Gas Companies. One of the
688 recommendations from the PwC involved staffing levels for the AMRP. The
689 potential also exists that the Liberty audit of the AMRP may also address
690 Peoples Gas' staffing levels for that project. My concern is that Peoples Gas
691 may, based on a Liberty audit recommendation, increase the staffing levels for
692 the AMRP by removing staffing from another area of the utility, causing a
693 reduction in safe operations in that area, but still complying with the proposed
694 FTE levels. To address my concern, I recommend the Joint Applicants modify
695 the language on the FTE commitment levels to include the phrasing "Peoples
696 Gas agrees and commits that it shall implement any increased staffing levels
697 recommended by the Liberty audit recommendations as an overall increase in
698 the agreed upon FTE levels for Peoples Gas."

699 **Q. What is your recommendation to the Joint Applicants regarding the FTE**
700 **staffing levels?**

701 A. I recommend that the Joint Applicants address and update the appropriate FTE
702 levels for its Gas Utilities and Integrys Business Support Group in their rebuttal
703 testimony. In particular, I request that the Joint Applicants provide an update that
704 is consistent with their response to Staff DR ENG 3.04. I also recommend the
705 Joint Applicants separate their FTE commitments into their individual companies
706 versus an aggregate value. Finally, I recommend the addition of the phrasing I
707 discuss above regarding the potential Liberty audit recommendation for Peoples
708 Gas' AMRP.

709 **Capital Expenditures**

710 **Q. Have the Joint Applicants provided information regarding the Gas**
711 **Companies expected future capital expenditures?**

712 A. Yes. Pursuant to Section 7-204(a)(7), the Joint Applicants in JA Ex. 4.1 provided
713 a forecast showing the capital requirements for the Gas Companies for the
714 period 2015 through 2019.

715 **Q. Have the Joint Applicants made a commitment to the Commission**
716 **regarding the Gas Companies' post-reorganization level of capital**
717 **expenditures?**

718 A. No.

719 **Q. Please explain why a commitment to maintain a minimum level of capital**
720 **expenditure investment is an important consideration when reviewing**
721 **whether the proposed reorganization will not diminish the utility's ability to**
722 **provide adequate, reliable, efficient, safe and least-cost public utility**
723 **service.**

724 A. If the Joint Applicants do not maintain the expected future levels of capital
725 expenditure investment for the Gas Companies it could diminish the Joint
726 Applicants' ability to provide adequate, reliable, efficient, safe and least-cost
727 public utility service. A reduction in future levels of capital expenditure
728 investment could affect the progress of the AMRP as well as other necessary
729 capital projects. In other words, I view the lack of a capital expenditure
730 commitment as a deficiency in the Joints Applicants ability to demonstrate the
731 proposed reorganization met the requirement in Section 7-204(b)(1).

732 **Q. What is your recommendation to the Joint Applicants regarding the Gas**
733 **Companies' future levels of capital expenditure?**

734 A. I recommend that the Joint Applicants provide a commitment on future levels of
735 capital expenditure broken out to specific amounts for North Shore and Peoples
736 Gas (AMRP and non-AMRP levels) for the years 2015 through 2017 using values
737 derived from JA Ex. 4.1. Since the amounts shown in JA Ex. 4.1 are confidential,
738 I also recommend the Joint Applicants provide the commitment values in a non-
739 confidential manner. Finally, I would note that the Joint Applicants should
740 provide support for the amounts selected, including full discussion of any

741 variances between the proposed values and the amounts shown in JA Ex. 4.1.
742 For example, the Joint Applicants responses to ENG 3.01 and 3.02 discuss why
743 certain values in JA Ex. 4.1 are not consistent with other responses provided to
744 Staff.

745 **Prior Integrys Merger Condition**

746 **Q. Are there any merger conditions from the Commission case that created**
747 **Integrys (Docket No. 06-0540) that you still monitor?**

748 A. Yes. The Gas Companies still provide reports regarding Condition # 24 from that
749 case. Condition #24 states:

750 The Gas Companies will: (i) provide the results of a query to
751 identify all active non temperature compensating meters set outside
752 and inactive non temperature compensating meters set outside
753 which become active, to the Director of the Energy Division as an
754 email on a weekly basis; and (ii) stop installing and or reinstalling
755 non temperature compensating meters by the later of January 1,
756 2007 or the date an order in this case is entered, subject only to the
757 availability of appropriate meters. (WPS, Peoples Energy Corp, the
758 Peoples Gas Light and Coke Company, and North Shore Gas
759 Company, ICC Order, Docket No. 06-0540, Appendix A, 5-6,
760 February 7, 2007).

761 **Q. Do you have any recommendations regarding Condition #24?**

762 A. Yes. I recommend the Commission direct the Gas Companies to cease
763 their reporting on Condition #24 because such information is no longer
764 needed.

765 **Q. Does this conclude your direct testimony?**

766 A. Yes, it does.